Select Committee on Pension Policy

P.O. Box 40914
Olympia, WA 98504-0914
actuary_st@leg.wa.gov

Executive Committee

June 21, 2005

12:30 - 2:30 PM

Senate Conference Rooms A-B-C, Olympia

AGENDA

(A) July Committee Meeting

(B) Other Business

(360) 753-9144
Fax: (360) 586-8135
TDD: 1-800-635-9993

July 19th – Meeting Planner

(June 7, 2005)

EXECUTIVE COMMITTEE AGENDA

(A) July Full Committee Agenda

(B)

(C)

FULL COMMITTEE AGENDA

(1) LEOFF 1 Benefit Cap

(2) Post-retirement Employment

(3) Plan 1 Unfunded Liability

(4) PSERS Eligibility

EXECUTIVE COMMITTEE AGENDA

(A) Directions on day's Full Committee Issues

(B) August SCPP Meeting

LEOFF 1 Benefit Cap

(June 14, 2005)

Background

When first founded in 1971, LEOFF 1 had no benefit cap. With the passage of Chapter 120, Laws of 1974, members' benefits were capped at 60% of final average salary. Those hired into LEOFF 1 positions on or after February 19, 1974 -- the effective date of the act -- are subject to the 60% cap; those hired prior to that date are not.

As of the 2003 valuation the LEOFF 1 Plan has 991 active members and 8,054 retirees. Of the remaining active members, 507 are subject to the 60% benefit cap.

Of the 8,054 LEOFF 1 retirees counted in the 2003 actuarial valuation, 2,344 became members prior to February 19, 1974. Of those, 659 had a benefit that was greater than 60% of their final average salary.

In addition to LEOFF 1 members hired on or after February 19, 1974, the Public Employees' Retirement System (PERS) Plan 1 and the Teachers' Retirement System (TRS) Plan 1 both have provisions capping retirement benefits at 60% of average final compensation (AFC).

The Plans 2/3, including LEOFF 2, have no benefit cap, but they are age-based plans as opposed to service-based plans. The School Employees' Retirement System (SERS), PERS and TRS 2/3 require members to be age 65 in order to receive an unreduced defined benefit. LEOFF 2 requires members to be age 53 to receive an unreduced benefit compared to age 50 in LEOFF 1.

History

Two bills were introduced during the 2004 legislative session related to the 60% cap in LEOFF 1. HB 2416 proposed raising the limit to 70% of FAS, and HB 2914 proposed eliminating the cap entirely; both bills received a hearing but neither moved from committee.

Companion bills HB 1873 and SB 5901 were introduced in the 2005 legislative session that proposed rescinding the LEOFF 1 60% cap. Neither received a hearing.

Policy Considerations

Among the general policies found in the funding chapter (RCW 41.45) is "Fund, to the extent feasible, benefit increases for all plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service." The average age of active LEOFF 1 members is 54 years, and their average member service is 29.3 years. For a plan that wasn't fully funded, there would be scant time to contribute to a benefit increase for an active membership that is already, on average, retirement eligible. Because LEOFF 1 is in surplus status at this time, any benefit increase would draw on that surplus.

Another policy concern would be leapfrogging. One of the common criticisms of the Plan 1 design is that member's benefits are maximized at 30 years of service (2% × 30 years of service = 60% of AFC). Were the cap raised or eliminated in the LEOFF 1 Plan, members of the Public Employee's Retirement System Plan 1 and Teachers Retirement System Plan 1 may request a similar benefit increase which would have a much higher cost.

Schedule

This issue is on the July agenda. The full committee will be presented a report that includes background, policy, and options discussions.

Policy Questions

To help the committee decide whether to move forward with this issue, they may want to deliberate by asking the following questions.

- Have the original goals and/or incentives changed?
- Is this benefit improvement in keeping with the policies acknowledging the need for earlier retirement among police officers and fire fighters?
- Is there a need to reward or retain long-tenured LEOFF 1 members? If so, what about PERS 1 and TRS 1 members?

- Can this issue be addressed outside the retirement system?
- Retroactivity?

Possible Options

If the committee wants to move forward with this issue, there are a number of approaches they could take. Here is a short list of possible options:

- Eliminate the benefit cap.
- Raise the benefit cap to a fixed level (64%, 66%, 68%, 70%).
- Eliminate the benefit cap, with a 1% (1.25%, 1.5%) per year accrual after 30 years of service.
- Raise benefit cap to a fixed level, with a 1% (1.25%, 1.5%) per year accrual after 30 years of service.
- Retain the current benefit cap.

Post-Retirement Employment

(June 14, 2005)

Background/History of Post-Retirement Employment in the Plans 1

The door to post-retirement employment was first opened in the Plans 1 in the mid-1960's. Since then there have been numerous changes to the pertinent plan provisions, most of which have involved the length of the waiting period between active employment and post-retirement employment, as well as limits on the number of hours that may be worked before retirement benefits are suspended.

In **2001** Washington State pension law was changed to expand post-retirement employment opportunities for members of TRS 1 and PERS 1. The hour limits for these plans were increased to 1500. The earlier limits had been 5 months for PERS 1; in TRS 1 the limits had been 525 hours for substitute teachers, 630 for substitute administrators and 840 for substitute teachers or principals in school districts with documented labor shortages. The new limits under the 2001 law translated to nine months in PERS 1 and a complete school year for TRS 1.

The 2001 law called for the State Actuary to study the fiscal and policy impacts of the act. If the State Actuary determined that the expansion of post-retirement employment options resulted in increased costs for the state retirement funds, the Actuary would propose a process to charge employers for them. The first report from the State Actuary on costs was presented in 2003. On December 16, 2003, the SCPP decided to defer action on the issue until further data and study was available, as there was an insufficient amount of experience data to determine the cost.

The JCPP studied post-retirement employment in **2002** and further legislative changes involving post-retirement employment occurred in **2003**. These changes only affected members of PERS 1. 2003 restrictions to the existing program included a new 90-day waiting period, a 1900 cumulative lifetime limit on the number of hours worked over 867 annually, a prohibition on verbal and written agreements to rehire a retiree, and increased requirements for documenting the need for the program and the hiring process used to fill that need. Similar provisions were proposed in 2003 for TRS 1, but they were vetoed. The SCPP studied the issue during the 2003 interim, and decided to defer further recommendations until enough experience was gained to determine the costs of the program.

During the **2004** legislative session, a non-SCPP bill was introduced as HB 2640. It would have brought parity to the Plans 1 by incorporating the 2003 PERS 1 changes into TRS 1. In addition, this bill would have required that employers of retired TRS 1 employees who work more than 867 hours in a school year pay both the employer contributions as if the member were active, and an additional amount of employer contributions equivalent to the TRS 1 employee contributions that the employee would have made if active. This bill did not receive a hearing in Appropriations.

In the 2004 interim, an SCPP subgroup studied post-retirement employment and looked at five bill drafts. The SCPP studied the issue in full and proposed legislation which would have brought parity to the Plans 1 by proposing additional controls in TRS 1, and which would have increased the "cumulative lifetime limit" to 3165 hours (worked over 867) for both plans.

During the **2005** legislative session, the SCPP's bill was introduced as House Bill 1326/SB 5244. A substitute bill, SHB 1326, would have changed the TRS waiting period to 45 days (from 90 in the original SCPP bill) and reduced the TRS cumulative lifetime limit to 1900 hours (from 3165 in the original SCPP bill). This bill passed the House but did not pass out of Senate Ways and Means. It is technically alive for the 2006 session.

Several non-SCPP bills concerning post-retirement employment were also introduced in 2005, though none passed. Some proposals were aimed at limiting abuse by restricting the program to a legislative list of positions. Public advertising was suggested to avoid "insider" agreements to rehire. One bill would have eliminated the program altogether. Another bill proposed policy and plan design changes that would encourage older workers to stay in the Plans 1 longer by 1) increasing the maximum retirement allowance from 60% to 70% of AFC , and 2) limiting post-retirement employment to 867 hours. At the end of the 2005 session, the operating budget bill included a directive to the OSA to study the retire-rehire program. This study will examine the fiscal impacts of the 2001 and 2003 legislation, and will present a range of legislative alternatives to the current program.

Preview of Alternatives, OSA Study

1. Increase the benefit accrual beyond 60% (required as part of the study mandate).
2. Revise the current program.
3. Repeal the current program.
4. Phased retirement.
5. Standard Deferred Retirement Option Plan (DROP).

Policy Considerations

The legislative challenge with respect to the post-retirement employment is to match the program design to the program goals. The OSA study will examine the policy implications of various alternatives, however it will be up to the policy makers to determine the goals of the post-retirement employment program. Some alternatives may advance the goal of alleviating sector shortages, assuming such shortages are still a problem. Some may address the need to retain older workers in the public workforce, and some may focus on attracting retirees back into the workforce after they have left.

Other alternatives may focus on preventing abuses in the existing program. Parity between PERS and TRS may be an issue, depending on the desired purpose of the program. The study will also look at overarching issues in the retirement system (such as funding policies and the UAAL in the Plans 1) as well as the pros and cons of questions such as whether the retirement system should be used as a personnel tool and whether the program is in keeping with plan design.

Where are we?

The SCPP's 2005 legislative proposal is technically alive for the 2006 short session. The OSA will conduct its own study during the 2005 interim and report to the fiscal committees and SCPP by no later than December 1, 2005. As of the date of the writing of this briefing paper, it is unclear whether the SCPP will want to conduct its own study during the 2005 interim.

Input Needed from the Executive Committee

1. Would the committee like to study this issue during the 2005 interim?

   - Has the issue been studied enough?
   - Is the committee satisfied with where it is?

2. If further study by the SCPP is desired, how would the committee like to proceed?

   - Parallel independent study? If so, what are the desired elements?
   - React to OSA study?

Decision Factors for the Executive Committee

1. Political and policy implications.

2. SCPP resources and other priorities for 2005-2006.

3. Timing of any action by the SCPP and how it fits into the existing work plan.

4. Independence from the OSA study.

Plan 1 Unfunded Liability

(June 14, 2005)

Background

According to the 2003 Actuarial Valuation Report, the Plans 1 have an unfunded actuarial accrued liability (UAAL) of approximately $4 billion. Employers are paying the UAAL over an amortization period that extends to June 30, 2024. This date approximates when all Plan 1 actives are expected to have retired. The Plan 1 UAAL payments represent a significant component of employer contribution rates, which are projected to increase significantly over the next several biennia. By 2007 it will cost 6.52% of payroll just to fund the TRS 1 UAAL alone. In addition, contribution rates must cover the normal cost of benefits, meaning that employer rates are projected to climb to ultimate levels of more than 9% for PERS, 14% for TRS and 11% for SERS.

State and local governments have expressed concern over their ability to cover the projected increases. A tight state budget has led to suspension of payments for the Plan 1 UAAL in the past and current biennia, and a phase-in of contribution rate increases as provided in ESHB 1044 (Chapter 370 Laws of 2005). As we have seen from the 2005 fiscal notes, delaying payment of the Plan 1 UAAL now means larger UAAL payments in the future. Not only is there a necessity to make up the skipped payments, but employers must also cover the interest that would have otherwise been earned had the payments been timely made. (This is like taking out a loan at 8%, as 8% is our assumed rate of return). Also, the magnitude of the fiscal impact of the Plan 1 UAAL is somewhat masked by smoothing, as we have yet to recognize some of the investment losses of the last bear market.

Policy Considerations

The Washington State Retirement Systems have a policy that requires funding benefits over the working lifetimes of members to the extent feasible. This policy is sometimes known as the policy for "intergenerational equity," since it attempts to spread the funding burdens fairly among generations of taxpayers. The assumption is that taxpayers should only pay for benefits for the workers who provide the services from which they benefit. In the case of the Plan 1 UAAL, this policy is clearly violated. The plan has been closed to new entrants since September 30, 1977. Current funding methodology spreads the responsibility for paying off this liability among employers for the Plans 1 as well as the Plans 2/3. The approach was set up to close a funding gap that had been long-standing.

In addition, current funding policy requires that the UAAL be fully paid by June 30, 2024. Payment of the Plan 1 UAAL has been "back loaded," meaning that UAAL payments must increase over time to reach the deadline of June 30, 2024. Under this scenario, proposed benefit improvements for the Plans 1 may seem to be much cheaper as a percent of payroll at this point in time than they really are, as the costs of such improvements don't appear to be affecting rates very significantly.

Where are we?

The SCPP's proposed legislation for phasing in contribution rate increases was contained in the so-called "combo" bill (HB 1324/SB 5246), and included a proposal for a minimum contribution rate "floor." These proposed rates would have included payments for the Plan 1 UAAL. This bill did not move from Appropriations and did not receive a hearing in Ways and Means. Also, a non-SCPP bill was introduced (SB 6085) that would have forbidden suspension of the Plan 1 UAAL payments until 2009, and then would have adopted minimum basic contribution rate floors that would have been effective until the actuarial value of assets equals 125% of the UAAL or June 30, 2024, whichever came first. That bill did not receive a hearing.

As of the date of preparation of this briefing, the Plan 1 UAAL is a topic in the proposed interim work plan. It is scheduled for July, when both the background and options will be presented for consideration.

Preview of Study and Options

1. Examine the issue in terms of short-term and long-term perspectives.

2. Examine the issue in the context of funding adequacy and other funding priorities.

3. Examine funding methodology and policy, i.e. who pays and why.

4. Examine how the Plan 1 UAAL affects basic rates, and in turn, how it impacts the funding policies of the retirement systems at large.

5. Examine the consequences of suspending UAAL payments.

6. Examine what kind of investment returns are required to avoid increasing UAAL rates.

7. Consider how demographics and growth assumptions are expected to affect projections.

8. Consider effects of all these factors on state and local budgets.

9. Examine the effects of smoothing on our perception of the UAAL and compare to market value.

10. Consider potential options for 2006 and beyond and look at costs.

    - minimum floors for the long-term
    - phase-in increases for the mid-term
    - look at short-term start up of UAAL payments in second year of 2005-07 biennium if revenue forecasts are favorable

Input from Executive Committee

1. Scope of the study: is there anything that the Executive Committee would like to add?

2. Options: are there additional options that the Executive Committee would like to see included?

Select Committee on Pension Policy

PSERS Membership Eligibility

(June 14, 2005)

Background

The Public Safety Employees' Retirement System (PSERS) legislation was sponsored by the SCPP and was passed into law as Chapter 242, Laws of 2004. It will take effect on July 1, 2006. This plan was established to acknowledge the law enforcement nature of certain public employee occupations that do not meet all the statutory criteria for membership in the Law Enforcement Officers' and Fire Fighters' retirement system (LEOFF).

These public safety employees are currently eligible to receive normal retirement after 5 years of service and attainment of age 65 in PERS 2; in PERS 3, it is 10 years of service and attainment of age 65. A Plan 2 member may receive an actuarially reduced early retirement after 20 years of service and attainment of age 55. A member with 30 years of service and age 55 may receive a benefit reduced 3% per year from age 65.

The PSERS benefit design includes:

- Regular retirement at age 65 with 5 years of service
- Unreduced retirement at age 60 with 10 years of service
- 3% early retirement reduction factor (ERF) from age 60 if age 53 with at least 20 years of service.
- Current disability benefit with an actuarial equivalent ERF from age 60.

When establishing the criteria for membership in PSERS, this committee deliberated over using an activity criteria or using a statutory occupational list. The committee decided in favor of a statutory occupational list so as not to incent those interested in membership from administratively changing their activities to qualify.

There are an estimated 7,200 PERS 2/3 members with positions eligible for PSERS membership currently employed by the Washington State department of corrections, the Washington State department of parks and recreation, the Washington State gambling commission, the Washington State patrol, the Washington State liquor control board, county corrections departments, and city corrections departments not covered under first class city retirement plans chapter 41.28 RCW.

The statutory list of those eligible for membership in PSERS includes city corrections officers, jailers, police support officers, custody officers, and bailiffs; county corrections officers, jailers, custody officers, and sheriffs corrections officers; county probation officers, probation counselors, and court services officers; state correctional officers, correctional sergeants, and community corrections officers; liquor enforcement officers; park rangers; commercial vehicle enforcement officers; and gambling special agents.

At the time of passage, it was acknowledged that the legislation probably missed certain occupational titles, particularly those with supervisory duties, and perhaps other occupations eligible for membership under the original policy guide lines. Because of the delayed effective date, it was felt that there was time for those who wanted to be included in PSERS membership to contact the committee or their legislators for consideration. No bills have been introduced to expand the membership since the passage of the original legislation.

Policy Considerations

During the original deliberations, the committee limited membership in PSERS to those with law enforcement types of responsibility and the authority to carry a firearm. Does the committee wish to maintain that membership criteria? Should policy on PSERS membership differentiate between supervisory and non-supervisory public safety positions?

Schedule

Following the background presentation at the July hearing, there will be a presentation in September where options will be discussed if the issue is advanced by the Executive Committee.